



Investrend Research

FINANCIAL INTELLIGENCE / Div., Investrend Communications, Inc.

www.investrendresearch.com / Disclosure • Accessibility • Scrutiny / Since 1996

P.O. 750471, Forest Hills, NY 11375-0471 / 718-896-5060 / Fax 718-896-5326 / contact@investrend.com

May 24, 2005

Mr. Jonathan G. Katz
Secretary, U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: **Comments for the SEC Advisory Committee on Smaller Public Companies
File No. 265-23**

Dear Mr. Katz and Advisory Committee Members:

In response to your request for comments, I am writing with respect to Item 7.5 under “Capital Formation” on your Committee Agenda, with the heading, “Analyze Analyst Coverage.”

As the CEO of Investrend Communications, Inc. (<http://www.investrend.com>), and managing director of its Investrend Research (<http://www.investrendresearch.com>) division, the oldest and largest independent fee-based research provider, I have a unique perspective from which to view the changes in the provision of analytics coverage for the past decade.

Almost ten years ago, Investrend Research devised a conflict-free or conflict-lessened system of independent coverage whereby companies enroll with Investrend for coverage, then Investrend and not the company selects the previously-qualified analyst and pays the analyst in advance for his or her initial report, after which Investrend is contracted to the analyst to publish and distribute the report the analyst produces. Investrend Research does not issue its own reports, only those for which the analysts, having already been paid, are solely responsible. We have qualified over 70 analysts and issued over 800 reports in this research “brokering” system.

Incidentally, while this commentary has not been vetted to the association, I am also executive director of the FIRST Research Consortium (<http://www.firstresearchconsortium.com>), whose 13 global Members have propagated what is considered the Golden Standard for our profession, the “Standards For Independent Research Providers;” and I have twice now provided an annual overview of the “State of the Industry” for research, and for reference, would incorporate the most recent presentation, for 2005, at http://www.investrend.com/Admin/Topics/Articles/Resources/927_1110668553.doc .

Investrend Research Syndicate also distributes the research of about ten independent research providers that have adopted the “Standards for Independent Research Providers,” at <http://www.firstresearchconsortium.com/standards.html> . These Standards are incorporated below as an Addendum.

In September, 2004, Investrend's counsel, Marshal Shichtman, Esq., submitted to the SEC Forum our position that SEC Regulation 17(b) loopholes must be closed to assure the transparency that governs the spirit of the Regulation, and regarding which SEC staff has said it has no guidance from the Commissioners. The SEC Forum forwarded this recommendation for clarity to the Commission, but to date no action has been taken.

COMMENTARY

First and foremost, we have seen surveys and statistics that indicate that overwhelmingly, investors are most likely to trust and utilize third-party professional analytics for their decisions than any other source. At the same time, due to the higher credibility that analysts have, by and large, in the investment community, as opposed, say, to the company's own pronouncements, investors generally assign a 10% to 40% higher valuation on, and significantly greater liquidity to, covered companies than those with no coverage.

The issue of analyst coverage, therefore, is a highly significant item to be considered by your Advisory Committee, since it regularly has the highest level of impact on trading activity.

A thorough, unconflicted, professional, credible system of analytics available to companies traded on any of the exchanges or listed on any of the listing services, will provide investors with a solid basis on which to determine the investment advisability any smaller public company; and at the same time, raise the liquidity and capital borrowing power of such companies who pass the scrutiny of or meet the milestones set by professional analysts.

To further assist the Advisory Committee, the following are the three basic types of analytics available to the markets today, along with my comments.

A. INSTITUTIONAL ANALYST COVERAGE

Provided principally for use within an investment bank or brokerage or for distribution to the clients of such banks or brokerages, institutional coverage is primarily conducted by salaried analysts employed by such institutions for which investment banking or brokerage services are the basis of their revenues.

Problems:

1. The number of companies under coverage has dramatically shrunk as an unintended consequence of the "Global Research Settlement" between the NY Attorney General, the SEC and some eleven investment banks. The smaller, less liquid public companies were the worst hit in the almost immediate reduction of coverages, a kind of investment class "cleansing," creating hundreds if not thousands of "research orphans."
2. Companies that survived the coverage plague now receive, inexplicably, via the mandated supplementary "independent" reports, even more coverage, primarily meaning that the rich got even richer as the poor went bankrupt. This was an intended consequence of the settlement but without any vetting within the industry; which, if that had occurred, would have commented that instead of allocating monies to more research for companies under coverage the settlement would have better served the investment community if those dollars had been allocated instead to provide coverage on "uncovered" companies.

Those who have analyzed the “independent” research provided as part of the settlement have noted that the funds available are insufficient to mobilize fresh, new independent research; and that investors receiving the supplemental research are not receiving as timely or often updated analytics comparable in quality to the research received from the institutions. Also, such research is often truncated or technical and not analytical at all, meaning that investors are not receiving “comparable” research.

3. Despite the massive layers of bureaucracy now employed by investment banks, only the eleven that settled have anyone looking over their shoulders. This leaves a considerable number of institutions, often covering the Smaller Public Companies, without extensive mandated oversight. Finally, the industry’s standard-setting organizations, such as the CFA Institute, the National Investor Relations Institute, and InvestorSide, with the single exception of the FIRST Research Consortium, have failed to mandate a conflict-free environment for the analysts themselves, allowing analysts who recommend equities to hold a stake in their ratings through holdings in the very equities they are covering.

Solution:

Analysts covering stocks should not, under any circumstances, own the stocks of companies they are covering, or any others in the companies’ sectors.

4. Very little, if any institutional research finds its way to individual investors, with the exception of clients of the firms by whom the analysts are employed. A significant problem, not to be overlooked, is that when it does reach individual investors, it is after a higher class of investor has received it and acted on it, or in truncated form, often simply that XYZ bank has “upgraded” or “downgraded” a company. This is equivalent to the abuses that occurred before Regulation FD, and is precisely the kind of selective disclosure that in its starkest terms, allows a bank to “pump” its research to its own clients and then allow them and their clients to “dump” their stock when the secondary buying comes in from the truncated and/or delayed public release of the report or its headline. This is a serious matter because a research upgrade or downgrade can have as much or more significant market response as a company development.

Solution:

Either a firm should provide its clients and the public with the same data at the same time, or provide only its clients with the data. If a headline or rating is released to the public, then the full report should be linked to the headline or rating. If the release to the public is a secondary release, the release should state clearly and transparently to whom it was previously released, and precisely when. The same transparency that governs issuers under Regulation FD should be employed for researchers.

B. INDEPENDENT SUBSCRIBER-BASED ANALYST COVERAGE

Provided principally to institutions such as hedge funds, money managers, banks, institutions and substantive individual investors, subscriber-based research is conducted by analysts employed by independent research providers for whom annual or individual-report subscriptions are the basis for their revenues.

Problems:

1. Subscriber-based research has little if any value to individual investors, as it is provided primarily to a higher class of investor, and often not redistributed in any form.

2. Because there is less demand by those willing and able to pay the substantive subscriber fees, the Smaller Public Companies and their shareholders are again short-changed.
3. When made available to the public, subscriber-based research has the same drawbacks as institutional research; that is, there are few if any links to the full report, and transparency is mostly lacking as to when the report was first released, and to whom. Often the information is made available to third-party carriers such as Briefing.com, NewRatings, Investars, and others, who in their public disseminations disclaim any transparency responsibilities described above in Paragraph “A.4.”
4. Because the research industry, and governing organizations such as InvestorSide for the subscriber-based community, or the CFA Institute, have not self-policed themselves to ban analysts or the research providers employing them from holding stock in the companies they cover, the subscriber-based model is often inherently conflicted because analysts providing ratings and recommendations may hold a stake in their ratings, lessening the probability of a warranted or timely downgrade.
5. Finally, there are threats to the financial underpinnings of the subscriber-based industry, such as proposals to ban the use of soft money to pay for such research. On the other hand, there is a question as to whether soft money should be used absent a requirement that the research produced should be available to the public, and at the least, not released absent a research report to the general investing community, or without disclosure transparency of when it was previously disseminated, and to whom.

C. INDEPENDENT FEE-BASED ANALYST COVERAGE

With their research provided equally to individual investors and institutions alike, and commissioned by the public issuers themselves, the industry originally birthed by Investrend Research has spawned a number of highly-qualified, standards-based research providers that provide professional, conflict-free or conflict-lessened analytics for the shareholders and investors on a commissioned basis, very similar to the ratings agencies and the audit professions.

Independent research providers who have adopted the “Standards” are listed at <http://www.firstresearchconsortium.com/members.html> . These are also attached hereto for the public record. There is no fee for adoption of the “Standards,” and adopters must pledge to oversight by their peers.

Problems:

1. Challenging the legitimate, credible providers are a number of conflicted “imitators” employing terms such as “research” or “analyst,” that bring discredit to the industry and perform a disservice to the investing public. Unfortunately, these latter are often aided and abetted by a handful of unprincipled Smaller Public Company executives or their promoters.

Solution:

Only research providers that provide the public with the credentials of their “analysts” and follow a minimal, published set of ethics should be authorized to use terms such as “analyst” and “research” in public communications that otherwise serve to confuse the public and the investor community.

We would respectfully propose that the Advisory Committee on Smaller Public Companies endorse a statement that issuers commissioning research should, minimally, employ only research providers that adopt the “Standards for Independent Research Providers.”

To further diminish the employment of outright promoters, whose communications clutter the investment community with noise that makes it more difficult for investors to distinguish between “pump and dump” operations and legitimate credentialed research, the SEC would be well advised to ban the usage of shareholder capital, i.e., stock, to finance such initiatives, either by the companies, their investor relations agencies, or third-party holders.

2. Only Smaller Public Companies or their significant shareholders that can afford to or will pay to commission research are covered, still leaving the vast majority without coverage. While the companies run the risk of investors questioning their prospects if they do not choose coverage, many companies choose instead visibility programs or outright promotions that provide their shareholders and investors with no credible third-party scrutiny or evaluation.

Solution:

A pooling, either with cash contributions or with stock contributions, into a centralized fund, and/or supplemented with exchange fees or brokerage commissions, such as is employed in some overseas exchanges, principally in Asia, could be devised as a means of funneling cash enrollment fees to qualified, standards-based research providers.

This could be mandatory or voluntary.

3. Insufficient disclosures and transparency are often the hallmark of unscrupulous promotions that are often disguised as or confused with standards-based research communications. Some employ junk faxes and spam emails to prey upon unsuspecting and undiscerning investors.

Solution:

SEC Regulation 17(b) provides a small measure of regulatory oversight into promotional transparency, but it is woefully lacking. The 2004 SEC Forum participants adopted a call for the Commission to close loopholes but that has not yet been acted upon by the Commissioners.

4. As discussed with Forum participants, an ancillary problem in transparency is that the public issuers themselves are not seemingly required under 17(b) to disclose whether compensation was involved, how much, what form, or by whom paid when it is the company itself which issues an announcement regarding a legitimate report or any investment-related activity such as a third-party webcast, or even a sham report.

Solution:

Regulation 17(b) should require issuers to meet the same transparency responsibilities as any other communicator when announcing such communications or the findings or activities of a third party that could possibly induce buying in a company’s stock.

5. A primary problem in transparency is that 17(b) does not require sufficient specific information necessary for a prospective investor to make a decision based on either a legitimate, credible report, a copycat report, or an outright promotion. The true nature of a “promotion” is obfuscated with disclosure that money or shares were paid by an unnamed “third party” and from or to a corporation without any information as to who is behind that corporation.

Solution:

When the compensation comes from a third party, the investor deserves to know the “natural person or natural persons” behind any “entity,” what the holdings are of that/those individual(s), where and how the payer received his/here shares, if a shareholder, and at what price, and what the specific selling intent is of both the third-party and the paid communicator is, if the communicator has also received or come about shares. Disclosure should also be made subsequently as to the proximity of any sales with the timing of the prior public communications.

6. Compensation with stock, whether free-trading or restricted, to either a legitimate analyst, research provider or a promotional firm, to be sold at any date after a report is undertaken creates an unhealthy, inherent and fatal conflict that does not serve the public’s interest.

Solution:

There is a school of thought that suggests that compensation in stock for credentialed analyst coverage is properly a shareholder expense rather than an overhead or operational expense, if the stock issued is not exorbitant and if it is disposed of prior to the announcement of coverage, meaning there are no holdings after the research is announced or undertaken. This is an alternative to the solution outlined in Paragraph “C.2” above.

The Advisory Committee would be responsible in stating, at minimum, that stock issued and held for sale at a date after any report or other communications regarding a company is unethical.

7. Dissemination of research and summaries linking to research is an essential element of the determination by legitimate independent research providers that the research is produced for the benefit of shareholders and investors, and not to any company or its executives or insiders. The availability of distribution channels via the company’s ticker symbol is therefore a necessity if the provider is to attain such a goal, and also to voluntarily fulfill the principles of Regulation FD, whether required by law to do so or not, as a matter of public interest. However, governed to a great extent by arbitrary rule-making by Yahoo Finance, which by default has become the most used resource for small investors making investment decisions, many of the more recognized press release disseminators, BusinessWire, PRNewswire, MarketWire and PrimeZone have devised varying policies, and in some instances no published policy at all, that work at odds with the goal of full and equal tickerized information distribution consistent with voluntary compliance with Regulation FD.

Solution:

Because research distribution is an overwhelmingly essential element of legitimate analyst reporting, the Advisory Committee would be well-advised to ask these press release channels and Yahoo and other key portals to submit their policies to the Advisory Committee for study, and to form a committee with recognized organizations such as the CFA Institute, National Investor Relations Institute, FIRST Research Consortium and InvestorSide to devise a method by which the legitimate research announcements may be

distinguished from the promotional clutter, which the policies and non-policies were haphazardly designed to eliminate. Some of these press release distributors, however, while turning down distributions for legitimate, credible research, nevertheless allow promotional and pump-and-dump releases, often employing ticker spam. The policies are fully inconsistent and do not serve the investment community interest. When the policy is that research must be published as “sourced” to the public company to assure tickerized distribution to the public, in another example, the public issuer gains a measure of control over whether or not it will allow the public to be advised of a downgrade. This is counterproductive.

We thank you for this opportunity, and hope that our comments will be helpful to the Committee.

Sincerely,

Gayle Essary

Managing Director, Investrend Research (<http://www.investrendresearch.com>)

CEO, Investrend Communications, Inc. (<http://www.investrend.com>)

ADDENDUM:

Standards for Independent Research Providers

The **FIRST Research Consortium**, founded in May, 2003 as an Association of Standards-Based Research Providers, recognizing that surveys indicate that three out of every four investors are “most influenced” by an analyst report, that nearly nine out of ten investors believe “legitimate fee-based research is objective and useful,” and that “*Enrollment in standards-based research is an important measure of a company’s commitment to transparency and Good Governance,*” has promulgated these “**Standards for Independent Research Providers,**” to serve as an ethical bond between enrolled companies and their shareholders.

1. **Ethical** precepts are an essential element of professional independent research, establishing the credibility necessary to understanding and accepting the research provider’s analytical output. Thus:
 - a. These *Standards* incorporate by inference the analyst “Standards and Ethics” of the CFA Institute, the “Issuer / Analyst Guidelines” jointly adopted by the CFA Institute and National Investor Relations Institute, and the appropriate language in NASD Rule 2711, Regulation AC, as well as other recognized industry guides; and
 - b. Once a company has enrolled for coverage, the responsibility of the fee-based independent research provider and its assigned analyst(s) is to the public and to a company’s shareholders and investors, and not to any company or to management.
2. **Qualified** analysts are fundamental to the production of valid analytics. Thus:
 - a. Only analysts credentialed by professional peer-reviewed organizations, or otherwise qualified by several years of supervised or supervisory research reporting for recognized financial institutions, and only adherents to the “Standards and Ethics” of the CFA Institute should be allowed to produce research published by fee-based independent research providers;

- b. The names and credentials of analysts producing the research should be included in reports published by independent research providers, along with an attestation thereto that the analyst's work product is purely his or her own without influence or interference; and
 - c. Only qualified analysts should determine what to publish and when to publish. Independent research providers are obligated to distribute the qualified analyst's report upon publication.
3. **Transparency** is vital to the publication and dissemination of investment data and fundamental analysis, and is an ethical responsibility of the fee-based independent research provider. Thus:
- a. Fee-based independent research providers should disclose all amounts of compensation received or to be received for the preparation, publication and dissemination of research, research summaries or other announcements not only in the reports but also in whatever form such material is disseminated;
 - b. All such communications should include the names and identities of the payers, and if a third-party or third-parties, their names and identities, as well as their relationship(s) to the issuer;
 - c. All such communications should also meet both the letter and the spirit of U.S. Securities and Exchange Commission Regulation 17(b);
 - d. If communications come from the issuer, it is the responsibility of the provider to advise the issuer that its reports or summaries may not be issued without the inclusion of these full disclosures, and if the provider is ignored, it is the responsibility of the provider to so inform the public; and further,
 - e. Ratings and targets should not be issued as recommendations or stock price predictors, and should not be issued or published in the absence of a full, publicly-accessible report. Where a report has been issued previous to a public announcement, the research provider has a responsibility to notice the investing public as to the date the report was previously issued, as well as who received the report.
4. **Conflicts** are inimical to credible professional research. Shareholders and investors need to feel comfortable that research is produced and published in an environment that is as free of analyst influences as possible. Thus:
- a. Analysts should not own a stake in their ratings. Neither they nor principals of independent research providers should own or trade any form of equities of companies under coverage;
 - b. Analysts should be paid for their initial reports in advance, or if salaried, the analysts' incomes should not be dependent on the outcome of their reports; and
 - c. Independent research should not be under the control of an investment banking department, investor relations or promotional firm or department or executive, and should not be produced or published under the auspices of an investment bank, investor relations or promotional firm or brokerage.
5. The **Mission** of the *Standards*-based independent research provider is to provide the investing public with an ethical, qualified, transparent and conflict-lessened fundamental analysis of public companies and their equities. Thus:
- a. Adopters of these "Standards for Independent Research Providers" agree to review by the FIRST Research Consortium Independent Research Standards Task Force, and agree that the Consortium may, at its sole determination, suspend, terminate or expel a Provider found to be in violation of these *Standards*.

